Re: PERSONAL - IS THIS WRONG? [UNCLASSIFIED] [Non-Record]

Tucker, Paul

Sent: 30 October 2008 13:32

To: jheywood

Will be sure to call later

----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul
Sent: Thu Oct 30 13:15:51 2008
Subject: RE: PERSONAL - IS THIS WRONG? [UNCLASSIFIED] [Non-Record]

WOuld welcome a conversation on this at some point - plus a more general update

-----Original Message-----
From: Jeremy Heywood
Sent: 28 October 2008 16:08
To: 'Tucker, Paul'
Subject: PERSONAL - IS THIS WRONG? [UNCLASSIFIED] [Non-Record]

There is a continued lack of short term money in the system. Although the BoE is offering a considerable supply of liquidity, the various facilities need eligible collateral. It is likely that the bank's have either insufficient eligible collateral to make full use of the facilities or that the collateral that would qualify has not yet been identified and used due to operational complexities.

The BoE's latest Long Term Repo (LTR) operation on 21st Oct offered £30bn of three month loans. Only £7.67 was taken up, at an average yield of 4.27%. This is despite GBP LIBOR being at 6.08% on the day. Given that use of the LTR carries no stigma and that funding remains in demand, the likely explanation is that the banks had insufficient collateral ready to make full use of the facility. An ~~alternative explanation is that~~ banks remain reluctant to lend funds seems unlikely, given that borrowing is happening in the interbank market at much higher rates (including when that borrowing is Government guaranteed).

The BoE could temporarily widen eligible collateral still further, to include bank paper: senior debt and certificates of deposit. The subscribing bank would be required to use paper other than its own, thus requiring a dual default from the subscribing and issuing bank before the BoE were exposed to loss. The BoE Consultative Paper "The Development of the Bank of England's Open Market Operations" October 2008 argued against allowing bank arguing that such actions would, in effect, be lending to the banking system secured against a claim on the banking system. However, the ECB and the Federal Reserve have both allowed bank securities as eligible collateral. (Sterling Libor has been stickier than $ and less so E libor)

The BoE could temporarily allow bank collateral at both the Discount Window and in the LTR's, but not in the longer term Special Liquidity Scheme. This would keep operational flexibility to withdraw the measure quickly, as liquidity conditions stabilise and the BoE wishes to both withdraw the monetary stimulus and reduce its exposure to the banking system as a whole

-----Original Message-----
From: Tucker, Paul
Sent: 26 October 2008 11:11
To: Jeremy Heywood
Subject: Re: Manythanks for fitting in supper [UNCLASSIFIED] [Non-Record]

Yep

In about an hour?

----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul; Scholar, Tom
Sent: Sun Oct 26 14:09:56 2008
Subject: LIBOR

Comment from UBS (in confidence - pl protect) In case you have not had this directly. Keen to discuss this general issue with you next week unless LIBOR does start to fall fairly sharply

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In summary Libor's decline is in train but it will be gradual. To speed it up a change in the guarantee fee (to bring it in line with the Dutch scheme) is called for. I am an advocate for speeding it up.

3 month Sterling Libor is the rate at which AA rated banks can borrow from one another. This is an unsecured borrowing rate. Libor is "fixed" at 10:30am by averaging across quotes submitted by a panel of reporting banks. In the last 3 weeks the market has noticed that both Barclays and RBS have bid, after the 10:30 fixing, at levels up to 5bps above the fixing throughout the rest of the day. Brokers report that when the Bank of England cut rates on the 8th October by 50bps at 12 noon Barclays continued to bid for cash at the higher 10:30am level. The market has been speculating over what these two banks might be doing and have interpreted these actions as a deliberate signal that they are prepared to borrow unsecured at 6.00%.

There is no incentive for lenders to offer funds after 10:30 at or below Libor when they know two banks will continue to pay above Libor throughout the remainder of the day.

For example, on 23rd October 3 month Libor fixed at 6.006%. RBS continued to bid 6.050% through the remainder of the day.

Why might Barclays and RBS behave like this? We believe it is because Libor borrowing is cheaper than any alternative, including the CGS. Barclays could issue a 3 month CD within the CGS at Libor less 100, at best (maybe Libor less 50bps). UBS estimates Barclays CGS guarantee fee is 124 bps (12 month median CDS plus 50bps) which gives an all in CGS cost of Libor+24 at best, i.e. significantly more than Libor borrowing WHATEVER level Libor fixes at. Additionally, avoiding the CGS signals that banks using the interbank market need no government assistance in borrowing.

Although Libor has fallen by 30 bps since the announcement of the Guarantee Scheme, the size of the fall has been impeded by the implementation. We view the Libor market as dividing between 3 borrowers (HBOS, RBS and Barclays) and two lenders (Lloyds and HSBC). The borrowers do not have a cheaper alternative and lenders see no pressure to offer funds more cheaply. There is no immediately apparent mechanism to change this stand off.

If the CGS fee had not included the 50 bps it would have produced a different dynamic. For example, Barclays could have issued a 3 month CD at Libor less 100 plus a fee of 74bps giving an all in cost of Libor less 26. In this case Libor borrowing would have been the second best option and the lenders in the money market would have known this. In this example the level of Libor less 100bps would probably have fallen to where 3 month Treasury Bills are trading (4.00%) and therefore Libor would be 5.00% (or Bank Rate plus 50bps). Furthermore, additional Bank Rate cuts would push TBill yields lower and therefore Libor too, rather than having Libor stuck at 6.00%.

Another aspect of the current CGS fee structure is that reductions in CDS do not feed into lower fees while the September turmoil keeps the fee high. If the averaging window was more carefully chosen and the fee reduced as CDS fell it might be possible to create a virtuous downward cycle in Libor.

For example, the Dutch who had the benefit of time to study the UK scheme chose different fees for short and long term borrowing. For less than 1-year they charge 50bps flat and for longer than 1-year they charge median CDS plus 50bps but with the median window running from January 2007 to August 2008, excluding the September turmoil.

If the UK followed the Dutch example for the CDS window, the CGS fee would fall by between 20 and 60bps but the all in fee would remain between 75bps and 110bps for the eight initial participants. Barclays fee would be 95bps, HBOS 75bps and RBS 65bps. While in theory this might give sub Libor funding in practice the benefit would be borderline.

Our suggestion is that it would be better to distinguish between short and long term use of the CGS and to charge a lower flat fee that ensures sub Libor funding at least until Libor reduces. We suggest initially following the Dutch example and using 50bps since this can easily be justified on competition grounds but would keep the fee under review as the market develops.

TYPED-UP VERSION OF E-MAIL OF 26 OCTOBER 2008

*****Original Message*****
From: Jeremy Heywood
To: Tucker, Paul; Scholar, Tom
Sent: Sun Oct 26 14:09:56 2008
Subject: LIBOR

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This email has reached the Bank via the Internet or an external network
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Comment from UBS (in confidence – pl protect) in case you have not had this directly. Keen to discuss this general issue with you next week unless LIBOR does start to fall fairly sharply

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If the UK followed the Dutch example for the CDS window, the CGS fee would fall by between 20 and 80 bps but the all in fee would remain between 75bps and 110bps for the eight initial participants. Barclays fee would be 95bps, HBOS 75bps and RBS 85bps. While in theory this might give sub Libor funding in practice the benefit would be borderline.

Our suggestion is that it would be better to distinguish between short and long term use of the CGS and to charge a lower flat fee that ensures sub Libor funding at least until Libor reduces. We suggest initially following the Dutch example and using 50bps since this can easily be justified on competition grounds but would keep the fee under review as the market develops.

RE: Manythanks for fitting in supper [UNCLASSIFIED] [Non-Record]

Jeremy Heywood

Sent: 25 October 2008 20:47

To: Tucker, Paul

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did u text me earlier?
when is a good time to talk>

Re: Might be scuttle butt - are u hearing this rumour? [UNCLASSIFIED] [Non-Record]

Tucker, Paul

Sent: 22 October 2008 22:50

To: jheywood

Yep. Dollar spreads still above ours at 3 months. But I'm concerned too, for both parts of our mission

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----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul
Sent: Wed Oct 22 22:49:04 2008
Subject: RE: Might be scuttle butt - are u hearing this rumour? [UNCLASSIFIED] [Non-Record]

thanks
obviously we are v concerned that US rates are tumbling but we remain stuck!

-----Original Message-----
From: Tucker, Paul
Sent: 22 October 2008 22:17
To: Jeremy Heywood
Subject: Re: Might be scuttle butt - are u hearing this rumour?
[UNCLASSIFIED] [Non-Record]

I know. But I don't think that can be all of it. Cos I don't think they'd be an influence on euro libor, which has also been sticky. But we are trying to monitor what's going on. Big question may be about non bank financial institutions

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----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul
Sent: Wed Oct 22 14:47:16 2008
Subject: Might be scuttle butt - are u hearing this rumour? [UNCLASSIFIED] [Non-Record]

From the money market trenches:

Sterling 3m Libor is high because Barclays are bidding it. They are bidding 2bps ABOVE Libor. This has been going on for three weeks. The day BoE cut 50 Barclays continued to bid the old level (as tho rates had not been cut). A lot of speculation in the market over what they are up to.

LIBOR spreads [RESTRICTED] [Record]

Jeremy Heywood

Sent: 22 October 2008 10:08

To: Tucker, Paul

any policy options we should be considering?

-----Original Message-----
From: Tucker, Paul
Sent: 21 October 2008 21:27
To: Jeremy Heywood
Subject: Re: Manythanks for fitting in supper [UNCLASSIFIED] [Non-Record]

Euro ones haven't fallen markedly either so far

Dollar ones were significantly higher

A handful of US banks have been lending fairly actively (that's a relative term)in dollars I think (think) that may have something to do with the fact that a number of US money centre banks have been enjoying flight to quality flows, whereas (no doubt overstating it a bit) that's been true of only hsbc in sterling and one bank can't turn a whole market.

Hope that helps a bit

Paul

-

----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul
Sent: Tue Oct 21 20:12:36 2008
Subject: RE: Manythanks for fitting in supper [UNCLASSIFIED] [Non-Record]

Hope all well

Why are UK LIBOR spreads not falling as fast as US?

-----Original Message-----
From: Tucker, Paul
Sent: 13 October 2008 20:31
To: Jeremy Heywood
Subject: Re: Manythanks for fitting in supper

That's quite something coming from where you sit!

Let's hope it works!!

-

----- Original Message -----
From: Jeremy Heywood
To: Tucker, Paul
Sent: Mon Oct 13 19:14:07 2008
Subject: RE: Manythanks for fitting in supper

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What a few days!

-----Original Message-----
From: Tucker, Paul
Sent: 06 July 2008 12:51
To: Jeremy Heywood
Subject: Manythanks for fitting in supper

V good to see you

Best

Paul